This record is a partial extract of the original cable. The full text of the original cable is not available.

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C O N F I D E N T I A L ANKARA 000606

SIPDIS

TREASURY FOR OASIA -- LOEVINGER, MILLS, PLANTIER
NSC FOR BRYZA, MCKIBBEN

E.O. 12958: DECL: 02/03/2010
TAGS: EFIN TU
SUBJECT: TURKEY IMF AGREEMENT IN TROUBLE OVER INVESTMENT LAW

Classified By: Classified by DCM Robert Deutsch. Reasons 1.4 (b) and (d).

¶1. (C) Summary. According to the local IMF representative, a Turkish government decision to move ahead with a regional investment incentives law is imperiling the Fund's December agreement on the terms of a new three-year stand-by program. Minister Babacan was apparently powerless to prevent Council of Ministers approval of the law, to which senior IMF officials, including Managing Director Rato and his deputy Krueger had expressed strong opposition directly to Prime Minister Erdogan. With the Fund feeling rebuffed, this development is part of an emerging and disturbing pattern of lack of Turkish commitment to a new IMF program. This has so far escaped the attention of markets, which tend to react abruptly and dramatically when surprised. End Summary.

¶2. (C) IMF Resrep Hugh Bredenkamp (strictly protect) said Treasury U/S Canakci informed him on the evening of February 1 that the cabinet and Prime Minister Erdogan had approved and were about to send to Parliament for final action a new law on regional investment incentives about which the IMF had previously expressed strong concerns to the Turkish government. The law, which Bredenkamp said would increase the number of regions available for such incentives and greatly expand company eligibility for incentives, would in the IMF's opinion invalidate the draft letter of intent that had been the basis of the December 14 public announcement of ad ref agreement on a new three year stand-by arrangment. Canakci told Bredenkamp that State Minister Babacan had been unable to prevent the cabinet's action. Babacan, he said, would try to hold up transmission to Parliament, but he doubted that he could do so for more than a few days.

¶3. (C) The IMF staff had been working behind the scenes to prevent the regional incentives law from moving foward. IMF Managing Director Rato sent a letter to Erdogan in mid-January warning that passage of the law could derail the December agreement. After the Turks did not reply to Rato's letter, Deputy Managing Director Krueger raised the subject in strong terms in a bilateral meeting with Erdogan in Davos. Erdogan left her with the understanding that the Turks and IMF would discuss and work together to find ways to make the law acceptable. Thus, IMF management was shocked to learn that the law had been approved by the cabinet and called a special informal meeting of the Executive Board for February 2 to seek guidance.

¶4. (C) Bredenkamp said that if the law passed through Parliament an IMF team would need to return to Turkey to renegotiate the letter of intent. More fundamentally, however, the issue was one of principle. If the law were to go forward it would demonstrate a lack of respect for the integrity of the national budget process that would be at odds with the entire point and purpose of IMF engagement with Turkey. He said Rato was firm that the IMF could not work with a partner that did not respect commitments. Options for IMF action, Bredenkamp thought, included a public statement of concern by the Fund spokesman in Washington. He also thought Rato could raise the issue during the upcoming G-7 ministerial.

¶5. (C) Comment: With the Treasury seemingly in crisis mode, Turkish officials have been unavailable to comment to us on this development. Cabinet approval of the incentives law (which has not become publicly known) comes at the same time as the GOT seems to be dragging its feet in implementing the three "prior conditions" on banking, tax, and social security legislation foreseen by the draft letter of intent. Bredenkamp said that the Fund accepted that there could be valid technical reasons for the lack of action on these laws. However, a disturbing pattern was emerging of a lack of commitment to the December agreement, including as ministers seem to compete among themselves in announcing populist schemes (such as the agriculture minister's call for an agricultural support or the labor minister's proposal for a fund for government payments to laid-off workers). It is even more disturbing that the Prime Minister seems to be taking the lead. This all fits with a more general pattern of wrong-headedness, including the recent announcement of

pharmaceutical regulations that had been strongly opposed by the EU and the United States as well as a new upswing in statements critical of the United States. Post recommends that we continue to take a very firm line in supporting Rato and the IMF.
EDELMAN